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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 80

THE UNITED STATES OF AMERICA

vs.

STEVENSON-CHISLETT, INC.

ON CERTIFICATE FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

FILED MAY 29, 1952

ORDER FOR ENTIRE RECORD JUNE 9, 1952

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 80

THE UNITED STATES OF AMERICA

vs.

STEVENSON-CHISLETT, INC.

ON CERTIFICATE FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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APPENDIX

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

No. 8117 Civil Action

STEVENSON-CHISLETT, INC.

v.

THE UNITED STATES

DOCKET ENTRIES

1949

Sept 21. Complaint filed.

Sept. 21. Summons issued.

Sept. 26. Summons returned served with copy of complaint on Edward Boyle, 1st Assistant U. S. Attorney for U. S. Attorney at Room 637 New Federal Bldg., Pgh., Pa. Sept. 21, 1949 at 3:20 P.M., EDST.; and by registered mail on the Attorney General of the United States Sept. 21, 1949, registered receipt and return receipt attached thereto.

Nov. 18. Stipulation filed and Order entered extending time for filing Answer to January 20, 1950.

1950

Jan. 18. Stipulation filed and Order entered extending time for filing answer to March 21, 1950.

Mar. 21. Stipulation filed and Order entered extending time for filing Answer to April 20, 1950.

April 19. Answer of Defendant filed.

1951

March 6. Subpoenas returned served on R. H. Maguire for W. T. Royston Co., and for W. S. Bonestell and W. T. Royston, at 908 Farmers' Bank Bldg., Pgh., Pa., March 6, 1951.

Mar. 7. Subpoena returned served on Mrs. William Seeds, for Mrs. Jean McKinney, at 5501 Center Ave., Pgh., Pa., on March 6, 1951, at 6:00 P.M.

Mar. 7. Subpoena returned served on Mrs. Bertha Wimmer, personally, at 1708 Trinity St., Pgh., Pa. on Mar. 6, 1951, at 3:15 P.M.

Mar. 8. Non-Jury Trial opens before Clary, J.

Mar. 8. Non-Jury Trial concluded C.A.V., Trial Memo filed.

Mar. 22. Transcript of proceedings hearing on Trial held March 8, 1951, at Pittsburgh, Pa., before Clary, J., filed.

April 20. Defendant's requests for findings of fact and conclusions of law filed.

Apr. 20. Plaintiff's requests for findings of facts and conclusions of law filed.

June 28. Findings of Fact and Conclusions of Law of Clary, J., filed and Order entered directing that judgment be entered in favor of plaintiff and against the defendant in the sum of $3,942.94, with interest on $985.74 from April 3, 1946, on $985.74 from June 24, 1946, on $985.73, from Sept. 25, 1946 and on $985.73 from December 17, 1946 pursuant to applicable provisions of Section 3771 of the Internal Revenue Code (26 USC Sec. 3771).

June 28. Pursuant to Findings of Fact and Conclusions of Law and Order, Judgment is hereby entered in favor of the plaintiff and against the defendant in the sum of $3,942.94 with interest on $985.74 from April 13, 1946, on $985.74 from June 24, 1946, on $985.73 from Sept. 24, 1946 and on $985.73 from December 17, 1946 pursuant to the applicable provisions of Section 3771 of the Internal Revenue Code (26 USC Sec. 3771). Stephen P. Laffey, Clerk.

Aug. 27. Notice of Appeal filed by defendant.

Aug. 27. Copy of Notice of Appeal mailed Clerk of Court of Appeals, and counsel of Record, also J. Clary.

[Caption omitted]

SUR PLEADINGS AND PROOF

This is an action instituted by plaintiff corporation under Section 1346 (a)(1) of the Judicial Code, 28 U.S.C. 1346 (a)(1) to recover the sum of $3,942.94 paid for income taxes for the calendar year 1945. From pleadings and proof I make the following

FINDINGS OF FACT

1. Stevenson-Chislett, Inc., a corporation, and the plaintiff herein, filed its Federal Income Tax Return for the calendar year 1945 with the Collector of Internal Revenue at Pittsburgh, Pennsylvania, on March 15, 1946, and it paid to him the income tax shown due on the return in the amount of $3,942.94 in installments as follows:

April 3, 1946	$ 985.74
June 24, 1946	985.74
September 25, 1946	985.73
December 17, 1946	985.73
	$3,942.94

No part of the said amount has ever been refunded or in any manner repaid.

2. On March 15, 1949, plaintiff filed with the aforesaid Collector a claim for refund of 1945 income tax, in the amount of $3,492.94, on the ground that plaintiff had sustained a loss by embezzlement, in the amount of $20,925.20, which was discovered during 1945; that said loss was not compensated for by insurance or otherwise; and that said loss had not been reflected in its 1945 return. The Commissioner of Internal Revenue

had rendered no decision on the claim for refund when this action was commenced on September 21, 1950.

3. Early in 1945, during an audit of plaintiff's books, a discrepancy of $24,135.14, as of December 31, 1944, was discovered between the accounts receivable control account in the general ledger and the total of the individual accounts receivable. Of this amount, $16,882.09 had been posted during October, 1944, as credits to the accounts receivable control account with no corresponding bank deposit. Later investigation determined that the exact amount of the discrepancy between the individual accounts receivable in the accounts receivable ledger and the accounts receivable control account in the general ledger as of December 31, 1944 amounted to $21,675.37.

4. Investigation revealed that the cashier-bookkeeper over a period of several years had manipulated the books and records of the plaintiff for the purpose of covering up cash shortages by accumulating for several months credit slips of individual accounts receivable accounts. Credit slips were posted in later months and there were usually several months of credit slips unposted to the accounts receivable control account in the general ledger.

5. The difference in the two accounts, $21,675.37, represented amounts embezzled from the plaintiff by a person or persons unknown. The said funds were not taken at one time but represented a succession of embezzlements covering an unascertained number of years. Because of the manipulation of the books and records by the cashier-bookkeeper, aided and abetted by an officer of the corporation, and the silence of other employees who knew of or suspected the manipulation, the responsible officers of the corporation did not discover the embezzlement and loss until 1945 when an audit and investigation disclosed the cash shortage.

6. The loss by embezzlement was not compensated for by insurance or otherwise.

7. In view of the series of embezzlements, the nature of the records available and the reluctance to cooperate on the part of the persons involved or suspected, it was a practical impossibility to ascertain the exact year or years in which the succession of shortages occurred.

8. An attempt to segregate the exact year or years in which such shortages occurred would have required a very detailed and extensive audit and investigation with no assurance that such investigation would have disclosed the actual dates of the acts of embezzlement.

9. Plaintiff used reasonable efforts and diligence under the circumstances of this case in attempting to ascertain the times at which the various embezzlements occurred.

10. Plaintiff made reasonable efforts to detect the identity of the guilty party or parties, including, among others, examination of the suspected persons by accountants and lawyers, detailed analyses of the personal bank accounts of suspected persons, and extended attempts to obtain a confession from the person toward whom suspicion most strongly pointed. It was only upon the considered advice of the plaintiff's attorneys that there was not sufficient basis to institute either civil or criminal action under the circumstances that the plaintiff abandoned its attempt to recover the amounts embezzled.

11. The plaintiff failed to deduct the said loss in its computation of net income in its return for the year 1945.

DISCUSSION

Throughout the trial of the case, and in its brief, the Government has taken issue with the plaintiff on several important facts; that the plaintiff has suffered a loss by embezzlement; that reasonable efforts were made

to attempt to place the dates of loss if they did occur; and that the plaintiff made reasonable efforts to determine the identify of, and obtain redress from, the guilty party or parties, if loss occurred.

The Government contends in this case that because of one fact elicited in a statement obtained from a witness and introduced in evidence at the trial, namely, that certain of the petty cash funds were used to pay for C.O.D. purchases, the plaintiff has failed to prove embezzlement. I do not so understand the evidence. It appeared clear to me that cash purchases were accounted for and that the amount, $21,675.37, represented unaccounted for shortages.

The Government further contends that if funds were embezzled or stolen, the loss was sustained in 1944 or in prior years to which it should have been apportioned. I agree that the actual thefts occurred in 1944 and prior years, and under ordinary circumstances should have been apportioned to those years. A detailed and extensive audit might have thrown some light upon the period during which the delays in posting took place, but such audit would have required checking with individual grocery store customers. This type of investigation would not only have been burdensome but presented little likelihood of success. Further, it is questionable whether such information would have ascertained the time of the acts of embezzlement. I find that under the circumstances it is not reasonable to require the taxpayer to expend substantial sums on an extensive audit which, at best, had little hope of success in fixing the times of the embezzlements which are the losses here claimed.

One contention of the Government has given me considerable concern, and that is its allegation that the plaintiff has failed to make a real effort to force an accounting from the person or persons who, according

to the evidence, might have been responsible for the shortage. The plaintiff can only be held to the exercise of reasonable diligence, and in this case I find that plaintiff did in fact exercise that degree of diligence required, by seeking the advice and assistance of competent auditors and attorneys. While Government counsel might disagree with the exercise of judgment by plaintiff's counsel in deciding against prosecution, and while I might likewise disagree, nevertheless, it is peculiarly the province of a lawyer to advise a client in a situation such as is involved in the present case. It is his responsibility to the client to evaluate the available evidence and on the basis of that evidence to properly advise the client as to what can or cannot be legally proved in either a civil or criminal action.

The taxpayer was entitled to rely upon the considered judgment and advice of its attorney. It is clear to me from the record that it gave to its counsel all available data and having done so it was entitled to rely upon counsel's advice that the evidence was insufficient to warrant the institution of either civil or criminal action. The plaintiff, therefore, exercised reasonable diligence in attempting to learn the identity of the guilty person or persons and in attempting to obtain redress.

The section of the Internal Revenue Code under which plaintiff claims the deduction is Section 23(f); 26 U.S.C., Sec. 23(f) which provides as follows:

> "Sec. 23. In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (f) LOSSES BY CORPORATIONS.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

CASES

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

NO. 79.

MARTHA L. ALISON

v.

THE UNITED STATES OF AMERICA.

On Certificate From the United States Court of Appeals for the Third Circuit.

BRIEF FOR MARTHA L. ALISON, Plaintiff-Appellant.

OPINIONS BELOW.

The Opinion of the District Court (R. 5, 6, 7 and 8) is reported at 97 F. Supp., 959.

The Court of Appeals did not file an Opinion, but certified a question of law involved to this Court (R. 11) concerning which it desired instruction for the proper decision of the case. This Court ordered the entire record sent up so that it may decide the entire matter in controversy (R. 11).

There are two apparently conflicting views of the law applicable to the facts as I have found them. The Court of Appeals for the Third Circuit in the case of the First National Bank of Sharon, Pa. v. Heiner, 66 F. 2d 925 (1933), held that an embezzlement occurring in a prior year could not be deducted in the year in which it was discovered but must be deducted in the year in which the loss occurred. On the other hand, in the case of Boston Consolidated Gas Company v. Commissioner of Internal Revenue, 128 F. 2d 473 (1942), the First Circuit held that the taxpayer could deduct in the year of discovery a loss occasioned by embezzlement of an employee where the actual date of occurrence of each separate act of embezzlement, as in this case, could not be ascertained.

Plaintiff has argued, and very persuasively, for the application of the apparently more liberal rule of the First Circuit. The opinion of Judge Woodbury in the Boston Consolidated Gas Company case stressed the fact that by the last sentence of Article 43-2 of the Treasury Regulation 86 (now Regulation 111, Sec. 29, 43-2), the Treasury Department itself provided that a loss from theft or embezzlement occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained, thereby impliedly recognizing that extraordinary situations warranted out of ordinary treatment. He further pointed out that while it was not the intent of Congress to permit a taxpayer to take a deduction for a loss in any year that might serve the taxpayer's particular purpose, it nevertheless was not the intent of Congress that such a rule should be inelastically and rigidly applied. He held, therefore, in that case that where a loss by embezzlement is discovered in one year, said loss having occurred in prior years but the dates of the takings of the funds could not be ascertained, that such a situation did not

call for the application of the *ordinary* rule but required the application of an extraordinary rule and therefore allowed the deduction in toto for the year in which it was discovered.

Judge Woodbury in his opinion in the Boston Consolidated Gas Company case, at page 476, regarded the ruling of the Third Circuit in the Sharon Bank case as conflicting with his. I do not agree. As I view the Sharon Bank case, the principal point upon which the case was decided was that an embezzlement may not be treated as a bad debt. A review of the record on appeal in that case reveals that it was decided upon a statement of claim and an affidavit of defense raising questions of law. It, therefore, leaves an area of doubt regarding certain facts of the case. The statement of claim alleged a total embezzlement by a bank employee during the years 1922, 1923, 1924, 1925, 1926, 1927 and 1928 of some $95,360.00 of which sum recovery was had from the defaulting employee and a bonding company of all but $20,000.00, which represented the amount embezzled prior to the coverage date of the bond.

Even after a review of the record on appeal, it is not clear whether the dates of the embezzlements were definitely ascertained. There were several factors, however, indicating that the times of embezzlement were actually known. For example, in the statement of claim it was alleged that $20,000.00 of the amount embezzled had not been recovered from the surety company because the embezzlement of that amount took place before the coverage date of the bond. This is an indication that the time of loss was known with at least some degree of accuracy. There is a further indication from the opinion of Judge Gibson in the lower Court, 2 F. Supp. 960 that the time of embezzlement was known. He stated at page 961, "* * * Unfortunately the period has expired during which an amended return could be filed

for the year of the embezzlement * * *". These two factors indicate that the times of loss were known. If they were, then the rulings in the Sharon Bank and the Boston Consolidated Gas Company cases are not inconsistent. The statement made in the opinions of both the District Court and the Court of Appeals, in the former case, that the deductions for embezzlement loss could be taken only in the year in which the embezzlement took place is, therefore, a statement of the general rule recognized by the First Circuit that ordinarily loss by embezzlement must be deducted in the year in which sustained.

The Court of Appeals for the Third Circuit has not, in my opinion, ruled squarely upon the question whether embezzlement losses, the actual dates of occurrence of which are unknown, are deductible in the year of discovery.

In view of the similarity of facts between the present case and the Boston Consolidated Gas Company case, it appears to me that the holding in that case is the only appellate authority in point on the facts and, therefore, controlling. Therefore, plaintiff's claimed deduction must be allowed and it is entitled to judgment in its favor.

CONCLUSIONS OF LAW

1. Stevenson-Chislett, Inc., plaintiff herein, prior to the taxable year 1945 sustained an embezzlement or theft loss in the amount of $21,675.37 which loss was discovered during the year 1945.

2. The embezzlement or theft loss, $21,675.37, composed of a series of embezzlements extending over a period of years, the exact dates of each separate act of embezzlement being unknown, is a proper deduction from gross income by the plaintiff for the taxable year in which discovered, 1945, under the provisions of Sec-

tion 23(f) of the Internal Revenue Code. 26 U.S.C. Sec. 23(f).

3. Plaintiff is entitled to judgment in the sum of $3,942.94, with interest.

An appropriate order will be entered.

[Caption omitted]

ORDER

AND NOW, to wit, this 28th day of June, A. D. 1951, for the reasons set forth in the Findings of Fact and Conclusions of Law filed in this case, it is

ORDERED, ADJUDGED AND DECREED that judgment be entered for the plaintiff and against the defendant in the amount of $3,942.94, with interest on $985.74 from April 3, 1946, on $985.74 from June 24, 1946, on $985.73 from September 25, 1946 and on $985.73 from December 17, 1946, pursuant to the applicable provisions of Section 3771 of the Internal Revenue Code, (26 U.S.C., Sec. 3771).

By the Court:

(S.) THOMAS J. CLARY,
D.J.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1952 931796 890

13a In United States Court of Appeals for the Third Circuit

No. 10599

[Title omitted.]

Certificate to the Supreme Court of the United States

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Statement of Facts

In the above-entitled case an appeal has been taken to this court by the defendant, the United States of America, from a judgment of the United States District Court for the Western District of Pennsylvania entered on June 28, 1951, in favor of the plaintiff, Stevenson-Chislett, Inc., a corporation, in a civil action instituted under Title 28, United States Code, § 1346 (a) (1), to recover the sum of $3,942.94 paid by the plaintiff for income taxes for the calendar year 1945.

14a From the pleadings and proof the district court made the following findings of fact which are not controverted by the parties on this appeal, namely:

"1. Stevenson-Chislett, Inc., a corporation and the plaintiff herein, filed its Federal Income Tax Return for the calendar year 1945 with the Collector of Internal Revenue at Pittsburgh, Pennsylvania, on March 15, 1946, and it paid to him the income tax shown due on the return in the amount of $3,942.94 in installments as follows:

April 3, 1946	$985.74
June 24, 1946	985.74
September 25, 1946	985.73
December 17, 1946	985.73
Total	3,942.94

No part of the said amount has ever been refunded or in any manner repaid.

"2. On March 15, 1949, plaintiff filed with the aforesaid Collector a claim for refund of 1945 income tax, in the amount of $3,492.94, on the ground that plaintiff had sustained a loss by embezzlement, in the amount of $20,925.20, which was discovered during 1945: that said loss was not compensated for by insurance or otherwise; and that said loss had not been reflected in its 1945 return. The Commissioner of Internal Revenue had rendered no decision on the claim for refund when this action was commenced September 21, 1950.

"3. Early in 1945, during an audit of plaintiff's books, a discrepancy of $24,135.14, as of December 31, 1944, was discovered between the accounts receivable control account in the general ledger and the total of the individual accounts receivable. Of this amount, $16,882.09 had been posted during October, 1944, as credits to the accounts receivable control account with no corresponding bank deposit. Later investigation determined that the exact amount of the discrepancy between the individual accounts receivable in the accounts receivable ledger and the accounts receivable control account in the general ledger as of December 31, 1944 amounted to $21,675.37.

"4. Investigation revealed that the cashier-bookkeeper over a period of several years had manipulated the books and rec-
15a ords of the plaintiff for the purpose of covering up cash shortages by accumulating for several months credit slips of individual accounts receivable accounts. Credit slips were posted in later months and there were usually several months of credit slips unposted to the accounts receivable control account in the general ledger.

"5. The difference in the two accounts, $21,675.37, represented amounts embezzled from the plaintiff by a person or persons unknown. The said funds were not taken at one time but represented a succession of embezzlements covering an unascertained number of years. Because of the manipulation of the books and records by the cashier-bookkeeper, aided and abetted by an officer of the corporation, and the silence of other employees who knew of or suspected the manipulation, the responsible officers of the corporation did not discover the embezzlement and loss until 1945 when an audit and investigation disclosed the cash shortage.

"6. The loss by embezzlement was not compensated for by insurance or otherwise.

"7. In view of the series of embezzlements, the nature of the records available and the reluctance to cooperate on the part of the persons involved or suspected, it was a practical impossibility to ascertain the exact year or years in which the succession of shortages occurred.

"8. An attempt to segregate the exact year or years in which such shortages occurred would have required a very detailed and extensive audit and investigation with no assurance that such investigation would have disclosed the actual dates of the acts of embezzlement.

"9. Plaintiff used reasonable efforts and diligence under the circumstances of this case in attempting to ascertain the times at which the various embezzlements occurred.

"10. Plaintiff made reasonable efforts to detect the identity of the guilty party or parties, including, among others, examination

of the suspected persons by accountants and lawyers, de-
16a tailed analyses of the personal bank accounts of suspected persons, and extended attempts to obtain a confession from the person toward whom suspicion most strongly pointed. It was only upon the considered advice of the plaintiff's attorneys that there was not sufficient basis to institute either civil or criminal action under the circumstances that the plaintiff abandoned its attempt to recover the amounts embezzled.

"11. The plaintiff failed to deduct the said loss in its computation of net income in its return for the year 1945."

The district court filed an opinion, which is reported in 98 F. Supp. 252, and reached the following conclusions of law:

"1. Stevenson-Chislett, Inc., plaintiff herein, prior to the taxable year 1945 sustained an embezzlement or theft loss in the amount of $21,675.37 which loss was discovered during the year 1945.

"2. The embezzlement or theft loss, $21,675.37, composed of a series of embezzlements extending over a period of years, the exact dates of each separate act of embezzlement being unknown, is a proper deduction from gross income by the plaintiff for the taxable year in which discovered, 1945, under the provisions of Section 23 (f) of the Internal Revenue Code. 26 U. S. C. Sec. 23 (f).

"3. Plaintiff is entitled to judgment in the sum of $3,942.04, with interest."

Thereupon the district court entered the following judgment:

"And now, to wit, this 28th day of June, A. D. 1951, for the reasons set forth in the Findings of Fact and Conclusions of Law filed in this case, it is

"Ordered, adjudged and decreed that judgment be en-
17a tered for the plaintiff and against the defendant in the amount of $3,942.94, with interest on $985.74 from April 3, 1946, on $985.74 from June 24, 1946, on $985.73 from September 25, 1946 and on $985.73 from December 17, 1946, pursuant to the applicable provisions of Section 3771 of the Internal Revenue Code (26 U. S. C., Sec. 3771).

"By the Court:

THOMAS J. CLARY,
D. J."

The present appeal to this court was then taken by the appellant. The appeal was heard by three judges of this court on February 20, 1952. Thereafter a rehearing before the court in banc was ordered by a majority of the circuit judges and was held on April 21, 1952 before six judges of the court, the seventh judge being disqualified to act. The six judges of the court who sat in the rehearing of this case being equally divided in opinion as to whether the plaintiff's loss of $21,675.37 by embezzlement was deductible

in computing its taxable net income for the year 1945 in which the loss was discovered, the court hereby certifies the following question of law concerning which it desires instruction for the proper decision of the case, to wit:

Question presented

When a taxpayer has suffered embezzlements over a period of years prior to 1945 but the actual years in which the several acts
18a of embezzlement took place are unknown and it is a practical impossibility to ascertain them, are the losses resulting from such embezzlements deductible by the taxpayer under Section 23 of the Internal Revenue Code in computing its taxable net income for the year 1945, in which year the embezzlements were discovered and the net loss therefrom was ascertained?

JOHN BIGGS, Jr.
Chief Judge.
ALBERT B. MARIS,
Circuit Judge.
HERBERT F. GOODRICH,
Circuit Judge.
GERALD McLAUGHLIN,
Circuit Judge.
H. E. KALODNER,
Circuit Judge.
WILLIAM H. HASTIE,
Circuit Judge.

19a [Clerk's Certificate to foregoing transcript omitted in printing.]

20a Supreme Court of the United States

No. 793, October Term, 1951

THE UNITED STATES OF AMERICA

v.

STEVENSON-CHISLETT, INC.

Order to send up entire record

June 9, 1952

Pursuant to the provisions of section 1254 (3) of Title 28 of the United States Code and par. 2 of Rule 37 of the Rules of this Court it is ordered that the entire record in this case be sent up so that the Court may decide the entire matter in controversy.

U. S. GOVERNMENT PRINTING OFFICE: 1952